DOW THEORY LETTERS INC.

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THE MARKET: Nothing can be proved yet, but I list below a number of the market indicators which I follow, and until proved otherwise, my feeling is that there is plenty of ground for suspicion regarding the staying power of this super-rally in a primary bear market.

I keep a daily tabulation of the "15 most active stocks" on the N.Y.S.E. (plus or minus differentials on a 3-day moving average). This index topped out at plus 26 on December 29, 1970.

My "group high-low index" (see later section of this Letter) topped at plus 13 on the week ending January 3, 1971.

The daily new high list on the N.Y.S.E. topped at 231 on January 18, 1971.

The five-day average of daily new highs on the N.Y.S.E. topped at 208 on January 22, 1971.

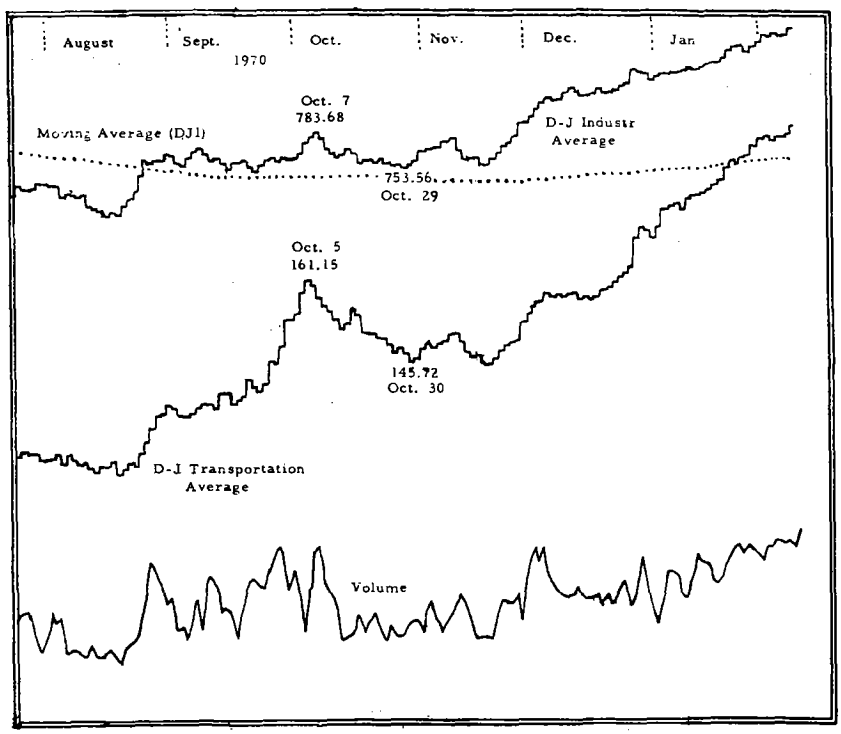
The D-J Utility Average hit its peak on January 19, 1971, at 128.39.

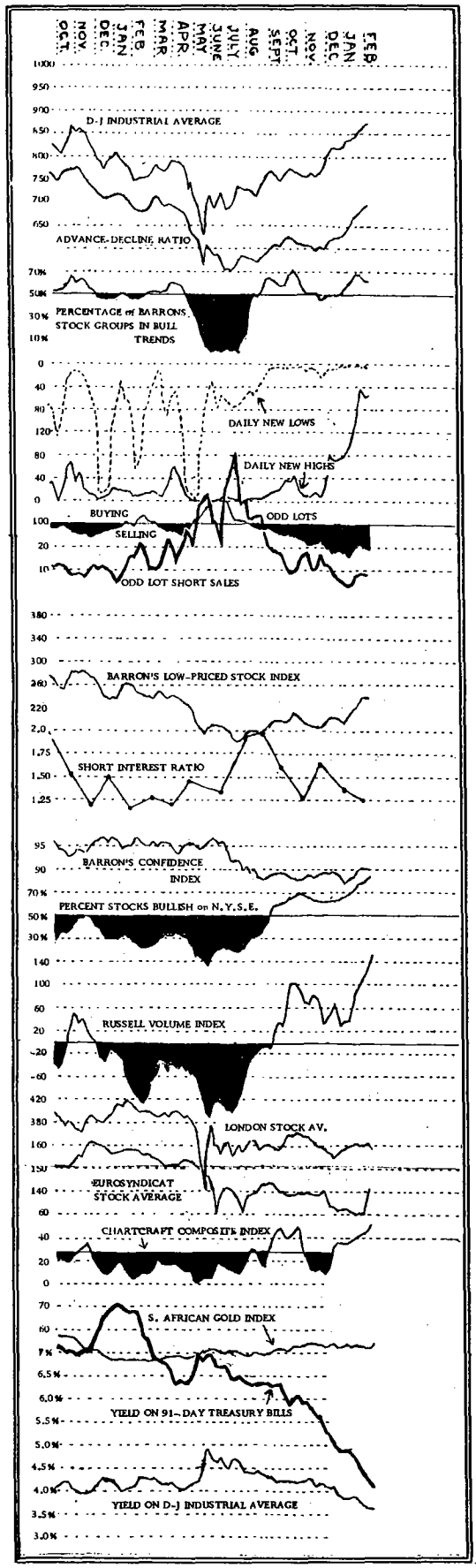
The D-J Industrial and Transportation Averages, as of this writing, are still recording new recovery highs, closing Monday (February 8) at 882.12 and 194.70, respectively.

The action of the past few weeks was accompanied by the highest volume in the history of the N.Y.S.E.

The market may go higher, but I would want the above indicators to start "proving themselves" on the upside. If they don't, then all the volume of the past month could indicate that we have seen one of the great distribution areas. We should know shortly.

Incidentally, here are two interesting pieces of information. On January 22, 1971, the Dow closed at 861.31 on volume of 21.6 million shares. On Friday, February 5, the Dow closed at 876.57. The total N.Y.S.E. volume





for those 11 trading days was 227.8 million shares. This means that it has required 15.2 million shares to move the Dow Industrials up each point since January 22. That's massive "steam under the market boiler" for very little action, and it smacks of heavy, heavy churning.

Second, few technicians are aware that the Dow can top out before the A-D ratio. For instance, to take the most recent top, the Dow halted its climb on December 3, 1968, at 985.21. Three trading days later the advance-decline ratio hit its high, a two-day decline occurred, and the A-D ratio then rose to the same high again — even while the Dow was falling. That spelled the beginning of the great 1969-70 decline. In other words, there's no law that says the Dow must top out before the A-D ratio.

THE PICTURE: For the first time in modern history, a Republican President has announced a deficit budget for the coming year. By now everyone knows that Mr. Nixon has announced a $229.2 billion budget with an intended $11.6 billion deficit for 1971-72. Many also remember that Mr. Nixon proposed a budget with a $1.3 billion surplus for 1970-71, but the final tally is likely to show a deficit of around $18.6 billion. Mr. Nixon is now proposing a deficit of $11.6 billion amid the worst inflation in 20 years. So all Mr. Nixon's pious words of a few years ago regarding our worst national problem, inflation, have gone down the drain. Our President now sees his worst problem as the election of 1972, and with that in mind he is hell-bent on getting the unemployment figure down to a level which will also get him votes.

With this type of hypocrisy at the highest Government level, who can expect more from the average citizen? Wages, prices, costs and everything else are now heading up at full speed with the latest announcement showing the consumer price index roaring skyward at a 6% rate in December. There is one area where the upward progress is open to question, however, and that is the crucial area of corporate profits (see chart). The Nixon forecast, bathed in almost unlimited optimism, forecasts a jump of $88 billion in G.N.P., a rise of $23.4 billion in revenue to the Government (vs. $.5 billion this year), and this is based partly on corporate profits jumping to a record $98 billion vs. $82 billion this year! In other words, if things don't turn out as fantastically well as Mr. Nixon predicts, the deficit for 1971-72 could go to $25 or $30 billion or beyond!

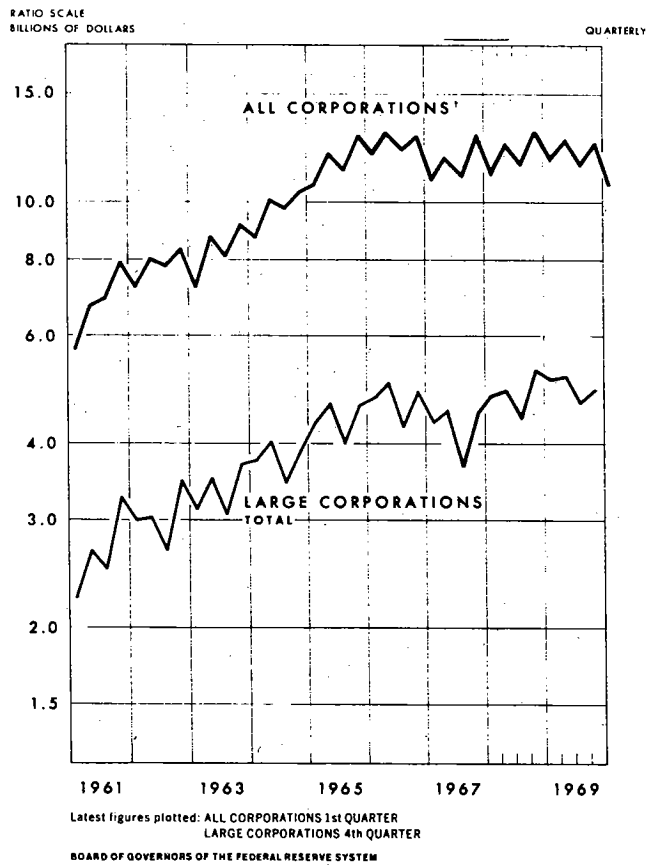
There is currently so much talk about G.N.P., unemployment, inflation and big budgets that the critical area, corporate profits, tends to be overlooked. But it should be remembered that the greater the activity without producing a comensurate rise in profits, the more dangerous the situation. For if all the fiscal stimulation since 1966 (see chart) could only result in lower profits for all corporations, what happens when the ultimate recession sets in?

In the last Letter I showed why this nation, as never before, cannot afford an economic slump. With gross interest payments moving ominously up towards the level of total corporate profits, any major slide in profits would be totally wiped out by interest payments. Interest payments are the non-variable in the equation; they continue on their relentless upward course. It is the profit level which is the variable, and if profits hold level or decline, the thin margin between gross interest payments and profits will be eaten away.

Meanwhile, the stock market continues to push upward on its corrective course, a correction given impetus by the rebound from the worst breadth (i.e., A-D ratio) collapse in market annals. But instead of viewing the current rise as a rebound from the collapse of 1969-70, Wall Streets propaganda-minded professionals are attempting to sell the rally to the public as a "new bull market". Nothing could be further from the truth, and the buying public knows it. As economist Eliot Janeway puts it in his January 27 report, "But the feeling that Wall Street has no problems is on a collision course with the fact that Washington still has no solutions." In a later section Janeway noted, "Business trends are confirming the fear in Washington and the confidence in the bond market, but hoisting an ominous question mark over the exuberance of the stock market. Recovery is not surfacing, but slump is spreading — and slump is entirely different from recession."

For months now Wall Street has taken it for granted that the cave-in in interest rates and the rally in the bond market will automatically (as occurred during previous bull market recessions prior to 1966)

PROFITS AFTER TAXES OF LARGE CORPORATIONS



pave the path for the next economic boom. For didn't the stock market advances (all to new record highs) beginning in 1949, again in 1953, again in 1957 and again in 1960 and again 1962 all reflect coming booms in the economy? Wasn't each advance during those years a golden opportunity to loan up on stocks and ride your business to the crest of a new peak in prosperity? Then why shouldn't the market advance which began in May, 1970, simply be more of the same? And the question may be asked, why wasn't the advance which began in November, 1929, carrying into April, 1930, more of the same? The answer is that a bear market started in September, 1929, and from that point until July, 1932, all rallies and all pick-ups in the economy were simply corrections in a great primary bear movement which resisted any and all solutions and manipulations which were brough forth in an attempt to turn the tide.

A primary bear market began in February, 1966, and the stimulations and manipulations ground out by the Government since that date have dwarfed anything even conceived of during 1929 to 1932. Yet at no time have the two Dow Averages ever bettered their 1966 highs (Transports alone did, during 1968-69), while the Industrial Average traced out a giant descending zig-zag of 995.15 in 1966 at the high, 744.32 in late-1966 at the low, 985.21 in 1968, and 631.16 in 1970. Neither I nor anyone else can tell how the bear market is fated to unfold from here, how high this rally will go before topping out, and how low the next major smash of the bear will carry. But before this bear market is over, the 631.16 low of 1970 will be shattered, and the Dow will be on its way to deep new lows which will seem well nigh impossible to the bulls of today.

And unfortunately, the history of primary movements suggests that the more manipulation, the more upside action, the more the Government strives to "hype" the economy and the stock market in its course against the prevailing primary bear trend, the greater will be the ultimate expression of the bear as it seeks to wipe out not only the excesses of the entire period of 1949 to the bull market top of 1966, but also to wipe out all the excesses since 1966, which have been built in as the Administration attempts to manipulate the primary bear trend.

It is not a pretty picture, and as I see it, it is building up to an ultimate climax which will be remembered throughout history as a monument to man's hypocrisy and arrogance. As I have said before, politicians deal with power, not truth, and when a government not only allows but feeds the forces of inflation in an attempt to protect its own power base, they are engaging in a kind of immorality which, throughout history has taken the nation involved to the brink of disaster.

Because politicians deal with power, not truth, they somehow believe that the people will also ignore the truth. It has never happened that way for long. I don't care how often Mr. Nixon tells the American people that prosperity will arise in 1971 and super-prosperity will appear in 1972, I don't care how often Government-paid economists promise the unemployment and inflation will subside next month and next month and next month, the people themselves are perfectly able to judge for themselves. The people have judged before on large issues, as any politician who ever had any dealings with the Vietnam war knows, and the people are doing it again now regarding inflation, unemployment and the economy.

As far as I can see, the Administration's options, options which might have been utilized successfully during the early 1960's or even after, are now about used up. Whereas a stiff and unyielding Government policy against inflation and over-expansion ten years ago might have resulted in a minor or severe recession and then a general leveling off of the economy, the same policy today would virtually wipe out corporate profits and take the nation to the depths of economic crisis. I have often said that it is one thing putting the brakes on when a car is going 25 M.P.H., and quite another putting on the brakes when a car is roaring at 110 M.P.H. Well the car is running at top speed, and the curve is coming up. I don't know any answers at this point except to suggest to the driver that he don his safety helmet and fasten his seat belt. And that, as I see it, is where we are now.

FRENZY: Few people are aware of what has been involved in holding back the primary bear market since it began in February, 1966. I have included a chart (page 4) showing the Federal budget surpluses and deficits since 1955. Note that since 1966, every year except 1969 has been subject to a deficit. Part of the deficits have been the result of pure deficit spending and expenses (much of it caused by inflation) surmounting income. Another reason for the deficits has been that tax receipts to the Government have been less than expected, due to poor business and dwindling corporate profits.

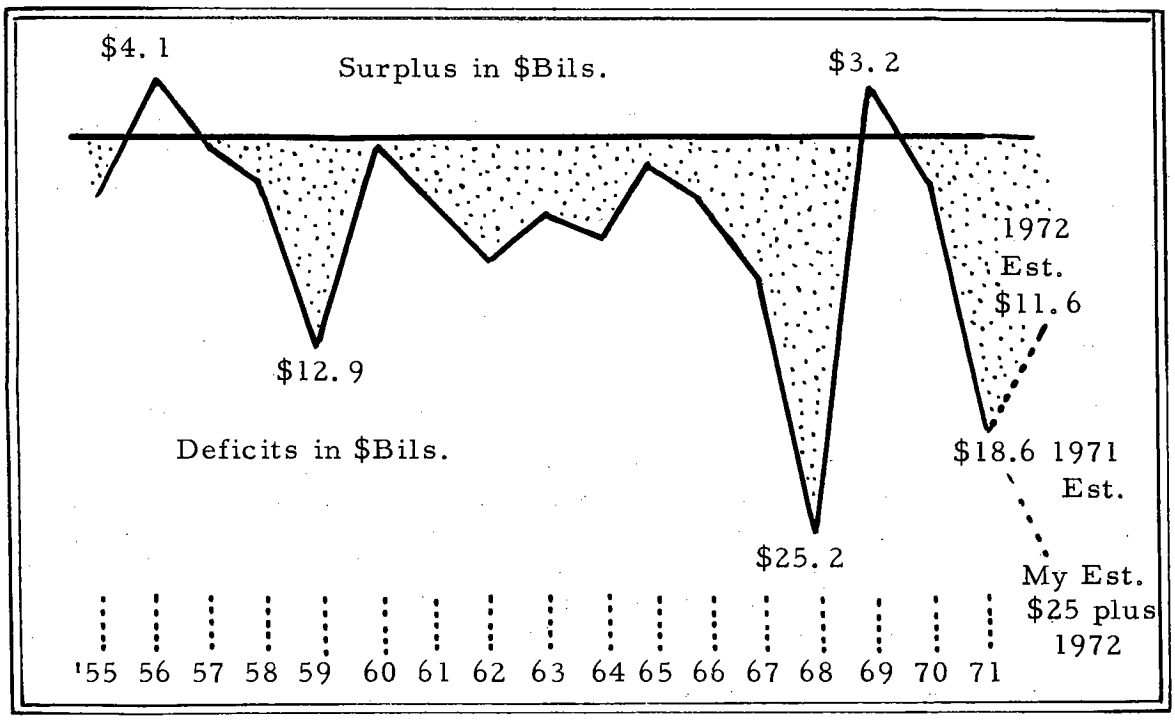
If we take the total of deficits (and the single surplus) since 1966 including the $18.6 billion estimated deficit for 1971, we see that there has been a grand figure of $59.9 billion in deficits so far, and despite these deficits the bear market has continued to hold Wall Street in its grip. The deficit for the coming year is estimated by the Administration at $11.6 billion, and this is based on everything, every variable from profits to employment "coming up roses". No margin is allowed for error. My own guess is that the fiscal '72 deficit could be nearer $25 billion, and if there is a real slump the deficit could go far above that figure.

And speaking of "margin for error", this little clip from last week's paper points to one possible error in the Administrations rosy new Keynesian game-plan variation. With interest rates down because of lack of loan demand, with the deficits still being pumped out here, Europe is piling higher than ever with dollars, dollars which can (and are being) cashed in for gold. Last week, amid giant churning on Wall Street, the price of gold rose to above $39 for the first time since last October and the gold shares headed sharply higher.

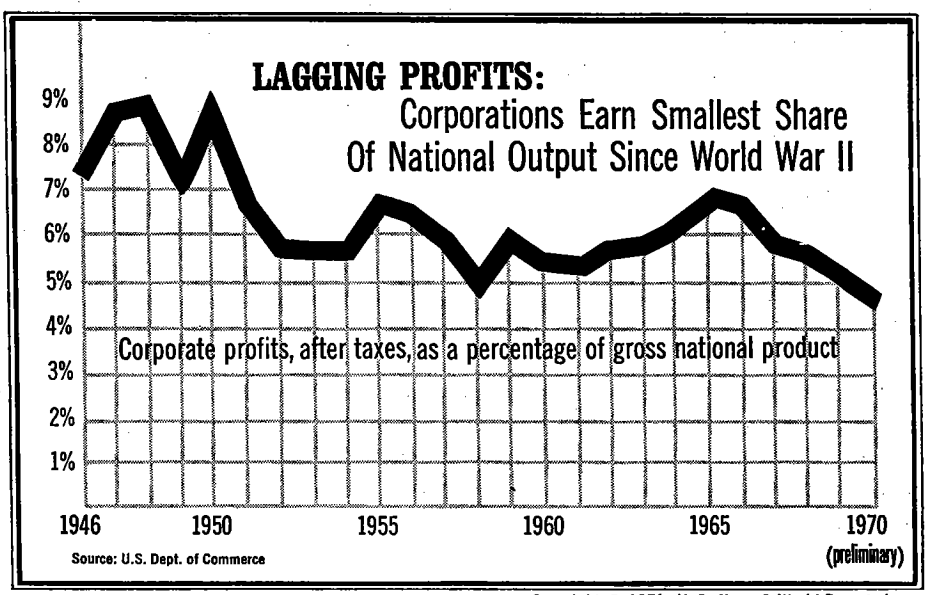
The second chart (from U.S. News and World Report) shows that despite the emphasis on rising G.N.P., corporate profits have not kept up. They are currently at a post-War low (1970) of about 4% of sales. Thus it is clear that it is taking greater and greater output just to keep total profits from collapsing. This is an ominous picture, since it implies that any major recession with a real drop-off in G.N.P. would send total corporate reeling into what could well be the minus column. If that occurred, Federal tax receipts would cave-in, and the Federal deficit would soar to astronomical and unsustainable proportions. To put it strongly, I do not think the nation could be in a more precarious position.

A European banker warned the U.S. on its large payments deficits.

Rinaldo Ossola, deputy director general of the Bank of Italy and a leading international monetary planner, warned the United States is courting a "calamity" with its persistent large balance of payments deficit. Speaking before the National Economists Club in Washington, Ossola said the problem lies in the "considerable increase" in 1970 of dollars piling up in the reserves of foreign central banks. The Federal Reserve Board recently estimated that dollar holdings in foreign central banks were about $19 billion at the end of November, up $8 billion from the end of 1969.



GROUPS: One of the indicators I use to check market momentum on the upside or the downside is the tabulations of Barron's new group highs and lows. Each week, on the next to the last page of Barron's, the 35 stock groups are listed, and an "H" (new high) or an "L" (new low) is placed next to each stock group which has managed to close at a new high or a low for the year.



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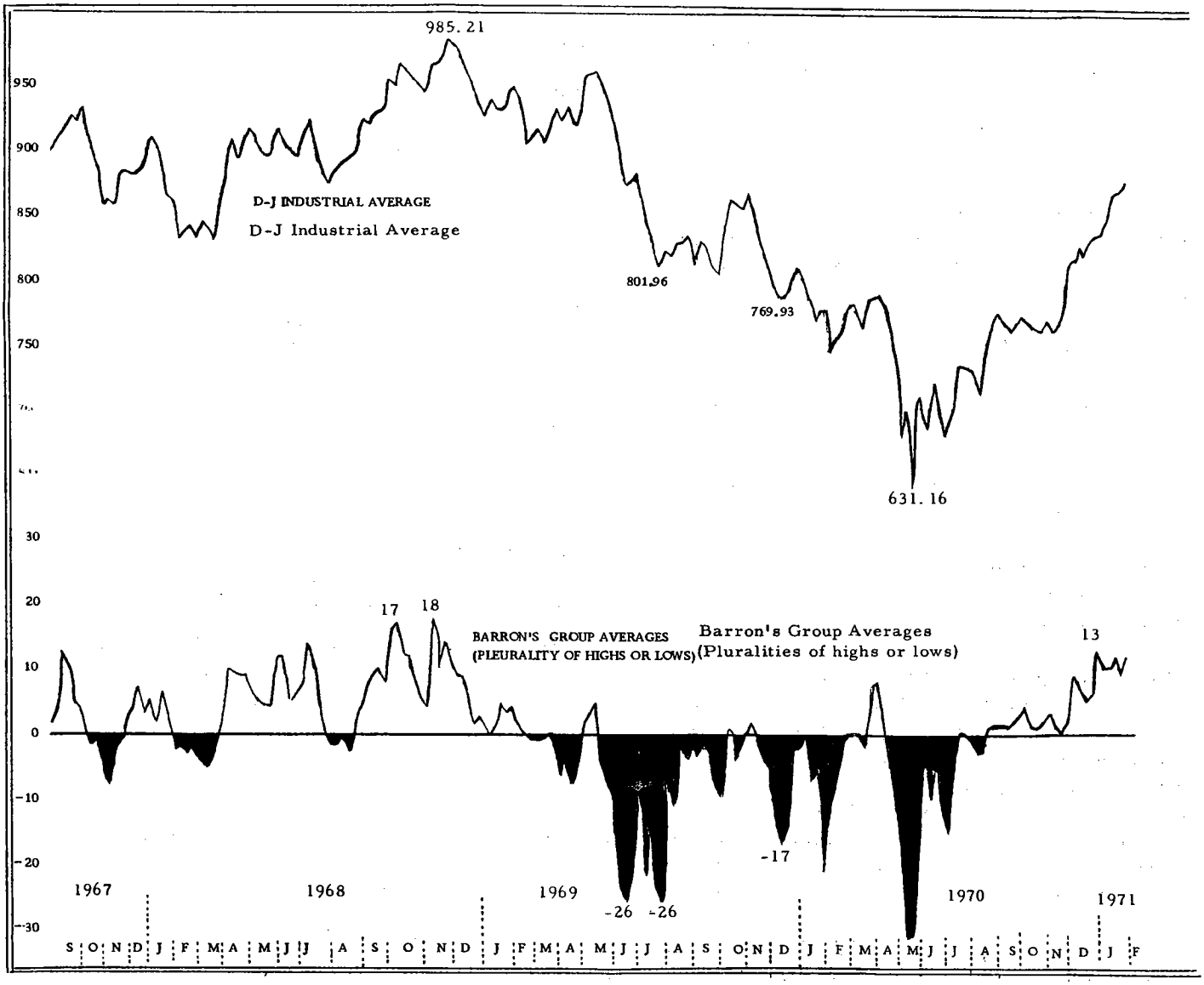


My figures are simply the net differential of new group highs and lows. For instance, if on a given week there are 15 new group highs and 5 new group lows, the figure entered on the chart would be plus 10, or the net differential on the plus side. The gold group is deleted from all computations, since it tends to run counter to the trend.

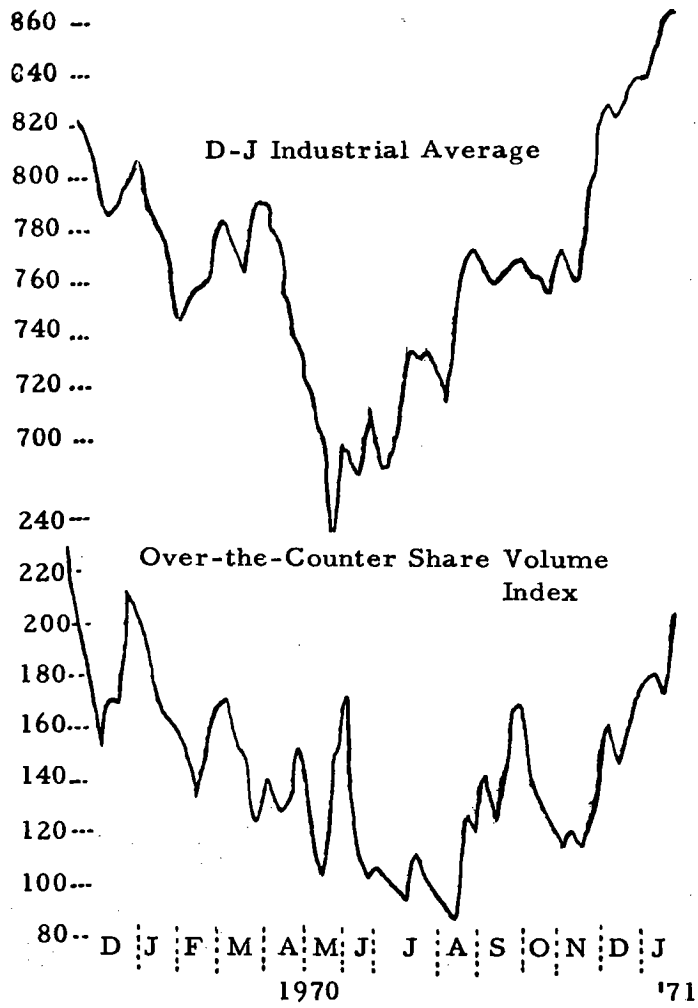
This group chart is important, since it identifies whether a movement is sweeping and broad in character or selective. For instance, if GM alone is strong in the auto group the upward movement of GM will play a part in moving the Dow Industrial Average to higher ground. But if the other stocks in the auto group such as Chrysler and Ford are laggard, then despite GM's strength, the group will not be able to record successive highs. This will show up in the tabulations of the number of new group highs during a market advance.

So far on the rise from the May, 1970, lows, the best showing for the new group highs was the plus 13 for the week ending January 4. That week closed with the Dow at 838.92. Five weeks later, on the week ending February 5, the Dow closed at 876.57, almost at the recovery high. Yet the new group highs checked in at plus 12, below the level of January 4.

Note that the Index touched its peak of plus 18 during November, 1968, just three weeks before the final Dow recovery high of 985.21. With group momentum sliding, the market sank, then collapsed during the entire year 1969 and part of 1970.

In the current situation, it has been five weeks since the 1971 Index peak of plus 13. The situation is particularly interesting, since the Group Index is not confirming the daily advance-decline ratio which as late as February 5 had established a new

recovery high. I might add, however, that this same situation occurred in late-1968, when the Group Index topped first, the Dow Industrials topped second, and the last to top out was the advance-decline ratio (at the 1968 top, the A-D ratio hit its high 6 trading days after the final high on the Industrial Average).



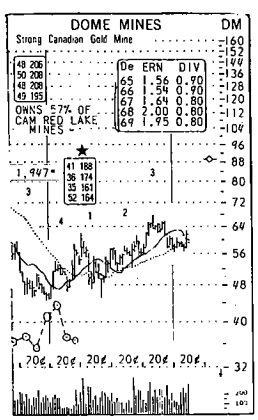
SPECULATION: With all the talk of whether there is speculation in this market, and if so how much, I thought I would include this chart which has been a good indicator of market speculation. It is the index of over-the-counter volume. The index is based on 100 equalling the average number of over-the-counter shares cleared during the first quarter of 1967.

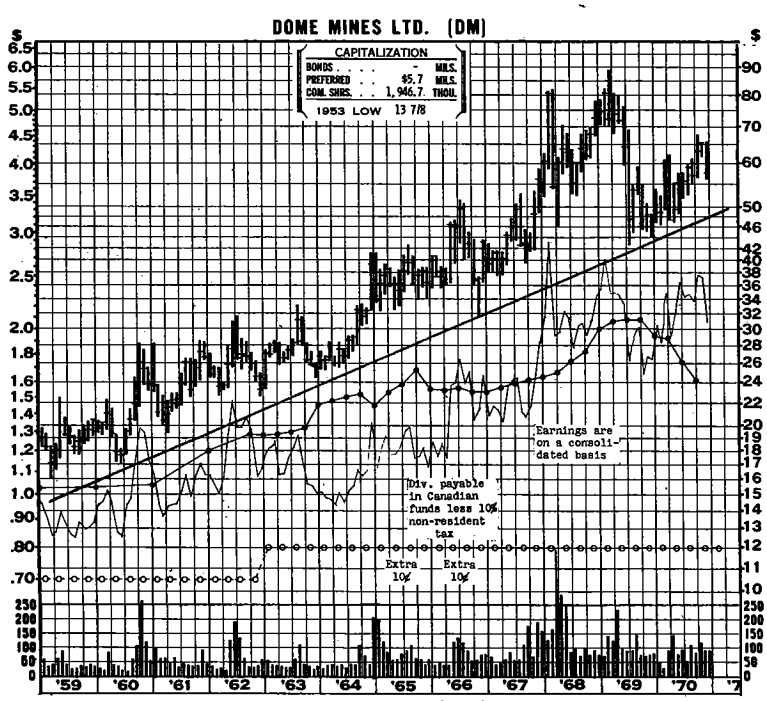
Note that as of now, the index has run full cycle and as of last week (volume figures are published weekly in Barron's) the index touched 213.3, highest figure since November, 1969, when the figure stood at 235.1. The record high for the index was touched in June, 1968, at 292.1. At any rate, speculation, according to this index, would seem to be rampant, and if it isn't as apparent on the still "crushed" Amex, it is in the over-the-counter market.

GOLDS: Perhaps the easiest of the gold shares to watch is Dome Mines, listed on the N.Y.S.E. Dome owns 57% of Campbell Red Lake plus shares in other gold mines and is a highly-regarded "holding company". Little noticed is the steady rise in DM from the 1959 low of 16 to the current price of around 64. Over the past week (see smaller weekly chart) DM has pushed above its 10-week and 30-week moving averages, probably in response to President Nixon's new Keynesian, deficit approach to the economy. Since the nation is now heading along a path which is calculated to scare all foreign holders of dollars, the pressure is again on the dollar and an upward price for gold.

I would say that the final "danger signal" would be a rush by DM above its 1969 high (over 90), and if that occurs it would almost certainly spell the final parting of the dollar with gold. Last week the Holt Investment Advisory stated, "We reiterate the prediction made last month: In 1971, the free gold price will reach record levels and the U.S. will demonetize the dollar". Sounds very likely to me.

(Large DM chart courtesy of Security Research Co., 208 Newbury St., Boston, Mass. 02116. Small chart courtesy of Quote Digest, 403 N. Main, Wichita, Kans. 67202).




DOME MINES LTD. (DM)
CAPITALIZATION
1953 LOW 13 7/8
Earnings are on a consolidated basis
Div. payable in Canadian funds less 10% non-resident tax
Extra 10¢
Extra 10¢
'59 '60 '61 '62 '63 '64 '65 '66 '67 '68 '69 '70